

# **MINUTES OF THE REGULAR MEETING OF THE ARIZONA STATE RETIREMENT SYSTEM BOARD**

**HELD ON  
December 19, 2003  
8:30 a.m., MST**

The Arizona State Retirement System (ASRS) Board met in the 10<sup>th</sup> Floor Board Room, 3300 N. Central Avenue, Phoenix, Arizona. Mr. Karl Polen, Chairman, Arizona State Retirement System Board, called the meeting to order at 8:33 a.m., MST.

The meeting was teleconferenced to the ASRS office at 7660 E. Broadway, Tucson, Arizona 85710.

## **1. Call to Order; Roll Call, Opening Remarks**

Present: Mr. Karl Polen, Chairman  
Mr. Norman Miller, Vice Chairman  
Ms. Charlotte Borchert  
Mr. Jim Bruner  
Dr. Chuck Essigs  
Dr. Keith Meredith  
Mr. Lawrence Trachtenberg  
Mr. Steven Zeman

A quorum was present for the purpose of conducting business.

## **2. Approval of Minutes of the November 21, 2003, Regular Meeting of the ASRS Board**

**Motion:** Mr. Jim Bruner moved to approve the minutes of the November 21, 2003 regular meeting.

Mr. Norman Miller seconded the motion.

By a vote of 8 in favor, 0 opposed, 0 abstentions, and 0 excused, the motion was approved.

## **3. Approval of Consent Schedule**

**Motion:** Mr. Norman Miller moved to approve Refunds, Death Benefits, Retirements, System Transfers, and the Applications and Agreements with:

- Green Valley Domestic Water Improvement District and Northern Apache County Special Healthcare District.

**And** approve the recommendation of the Investment Review Committee for the extension of Large Cap and Small Cap External Investment Manager contracts for a one-year period. **And** approve the recommendation of the Planning, Budget, and Audit Committee to award the Actuarial Audit contract to Milliman USA. **And** approve the recommendation of the Planning, Budget and Audit Committee to award the Document Imaging hardware, software, and professional services contract to Convansys.

Ms. Charlotte Borchert seconded the motion.

By a vote of 8 in favor, 0 opposed, 0 abstentions, and 0 excused, the motion was approved.

#### **4. Presentation, Discussion and Appropriate Action Regarding Fiscal Year 2002/2003 Audit Findings and Annual Report**

Mr. Steven Zeman gave a brief presentation on the audit findings for Fiscal Year 2002/2003 which ended on June 30, 2003, citing that the audit found no problems or irregularities.

**Motion:** Mr. Steven Zeman moved to approve the Planning, Budget, and Audit Committee's recommendation to accept the External Audit and authorize distribution of the Comprehensive Annual Financial Report for Fiscal Year End June 30, 2003 to Gov. Janet Napolitano and to the Arizona Legislature.

Dr. Keith Meredith seconded the motion.

By a vote of 8 in favor, 0 opposed, 0 abstentions, and 0 excused, the motion was approved.

Mr. Zeman also noted that for the fourteenth year, the ASRS has been awarded a Certificate of Excellence from the Government Finance Officers Association for its fiscal report ending FY 2002. Mr. Zeman recognized Ms. Nancy Linssen and Ms. Jan Holt for their work and accomplishments.

#### **5. Presentation, Discussion and Appropriate Action Regarding the ASRS Appeal Process**

Mr. Thomas McClory, Assistant Attorney General, addressed the Board regarding the appeal process to the ASRS Board. Mr. McClory presented a draft proposal on how the appeal process should work. After review of the proposal, Mr. Norman Miller suggested that Item 1 in the proposal be changed from "...ASRS staff shall promptly review..." to "...an ASRS assistant attorney with the assistance of staff shall promptly review..."

Mr. Miller also inquired about Item 3c of the proposal and asked if an appellant would be able to submit a rebuttal to the appeal summary. Mr. McClory stated an appellant would be stating their position in the appeal itself, so no rebuttal is necessary.

Mr. Miller addressed Item 4b of the proposal. He inquired as to expanding the item to include the phrase "or counsel selected by the Director." Mr. McClory consented to the request.

Dr. Chuck Essigs asked if the staff had flexibility in determining if a disputed issue would have to go through a full administrative hearing. Mr. McClory said that the staff does have flexibility in making sure the process is streamlined.

Ms. Charlotte Borchert expressed concern about the cost of an attorney for a retired member who would make an appeal. Mr. Jim Bruner stated he supported the proposal as something that was beneficial to both the Board and appellants. Mr. Miller inquired as to whether or not the ASRS had the authority to reimburse a retiree or applicant attorney's fees and costs. Mr. McClory stated that in his experience, an attorney is not necessary in an administrative law proceeding because it is more relaxed.

**Motion:** Mr. Norman Miller moved to accept the appeals policy with changes to Item 1 and 4b as stated.

Mr. Lawrence Trachtenberg seconded the motion.

By a vote of 8 in favor, 0 opposed, 0 abstentions, and 0 excused, the motion was approved.

#### **6. Presentation, Discussion and Appropriate Action Regarding the 2004 Board Meeting Calendar**

**Motion:** Mr. Jim Bruner moved to accept the 2004 Board Meeting Calendar as presented.

Mr. Lawrence Trachtenberg seconded the motion.

By a vote of 8 in favor, 0 opposed, 0 abstentions, and 0 excused, the motion was approved.

#### **7. Presentation, Discussion and Appropriate Action Regarding Notice of Final Rulemaking, Repealing R2-8-101, R2-8-102, R2-8-103, R2-8-105, R2-8-124, R2-8-125**

Ms. Charlotte Borchert stated the final rulemaking and repealing did not go through the Rules Committee as there was no public comment.

**Motion:** Ms. Charlotte Borchert moved to approve the Notice of Final Rulemaking repealing R2-8-101, R2-8-102, R2-8-103, R2-8-105, R2-8-124, and R2-8-125.

Mr. Lawrence Trachtenberg seconded the motion.

By a vote of 8 in favor, 0 opposed, 0 abstentions, and 0 excused, the motion was approved.

#### **8. Presentation, Discussion and Appropriate Action Regarding the External Affairs Committee Review and Recommendation of the 2004 Proposed Legislative Bills**

Mr. Norman Miller gave a brief overview of the proposed legislative bills for the coming session in 2004. He gave compliments to the ASRS staff and director for their hard work on the

proposals. He also stated that he requested that Mr. Richard Stephenson, Deputy Director for External Affairs, not distribute anything resembling legislative bills because they may change as they work their way through the process.

Mr. Richard Stephenson gave a presentation on the five proposed policy initiatives for 2004. The policies are: 1) Service Purchase Program Related, 2) LTD Program Related, 3) Asset Management; Limitations, 4) Retirement Incentives and Employer's Payments, and 5) Technical Corrections. Mr. Stephenson also said the Legislature may take up the issue of political subdivisions and their participation in the retirement system.

Dr. Chuck Essigs complimented the staff for their hard work on the bills. Ms. Charlotte Borchert stated the staff has done a good job in making the presentation material streamlined and readable.

Dr. Keith Meredith inquired as to whether or not the proposed bills would solve some, most or all of any abuses in the system. Mr. Stephenson said the Director is taking steps to make sure that what is not covered in the bills will be handled either internally or in future legislative initiatives.

Mr. Karl Polen opened the floor for the public to speak on this issue.

Dr. Robert Letson addressed the Board via teleconference from Tucson. Dr. Letson made reference to the issue of the ASRS Board following the Arizona Constitution and cited it to state that the ASRS funds are not state funds and therefore the ASRS Trustees' duty is not to balance the interests of the State or the taxpayers or to please everyone who wants something from the System, but to act solely in the interest of the beneficiaries.

**Motion:** Mr. Norman Miller moved to direct staff to make the legislature aware of the inequities or inconsistencies in the Service Purchase Related statutes.

Mr. Lawrence Trachtenberg seconded the motion.

By a vote of 8 in favor, 0 opposed, 0 abstentions, and 0 excused, the motion was approved.

**Motion:** Mr. Norman Miller moved to direct staff to seek sponsors, introduction, and favorable legislative disposition of draft bills entitled: 1) "LTD Program Related," 2) "Asset Management; Limitations," 3) "Retirement Incentive Programs; Employer Payment," and 4) "Technical Corrections."

Dr. Keith Meredith seconded the motion.

By a vote of 8 in favor, 0 opposed, 0 abstentions, and 0 excused, the motion was approved.

## **9. Presentation, Discussion and Appropriate Action Regarding the Fixed Income Manager Selection**

Mr. Jim Bruner addressed the Board regarding the Fixed Income Manager Selection.

**Motion:** Mr. Jim Bruner moved to approve the recommendation of the Investment Review Committee for the award of the fixed income contracts to BlackRock and Fidelity Investments as Core-Plus managers; JP Morgan as a Core manager; and PIMCO as a back-up Core or Core-Plus manager. **And** approve the associated guidelines for the aforementioned managers. **And** move to approve the funding of approximately \$400 million to Fidelity Investments which will come from the F1 portfolio.

Mr. Norman Miller seconded the motion.

By a vote of 8 in favor, 0 opposed, 0 abstentions, and 0 excused, the motion was approved.

Mr. Bruner acknowledged the hard work by Mr. Lawrence Trachtenberg on this issue.

#### **10. Presentation, Discussion and Appropriate Action Regarding the Investment Consultant Contract**

**Motion:** Mr. Jim Bruner moved to approve the recommendation of the Investment Review Committee for the award of the primary investment consulting services contract to Mercer Investment consulting. **And** approve the recommendation of the Investment Review Committee for the award of the contract for back-up investment consulting services to Callan Associates. **And** approve the recommendation of the Investment Review Committee for the award of the contract for special projects only, to R.V. Kuhns.

Mr. Norman Miller seconded the motion.

By a vote of 8 in favor, 0 opposed, 0 abstentions, and 0 excused, the motion was approved.

#### **11. Presentation, Discussion and Appropriate Action Regarding the Total Fund Performance Overview on the Period Ending September 30, 2003.**

Mr. Terry Dennison, Principal, Mercer Investment Consulting, presented an economic and market review and reported on the Total Fund for the period ending September 30, 2003.

	<b>Quarter</b>	<b>1 Year</b>	<b>3 Years</b>	<b>5 Years</b>	<b>Inception</b>
<b>Total Fund</b>	3.50%	20.00%	-3.10%	4.50%	10.80%
<b>Benchmark*</b>	2.80	19.10	-3.90	2.80	8.90
<b>RM Public Funds Median</b>	3.60	18.90	-1.60	5.10	-
<b>Percentile Ranking</b>	60	34	87	77	

\*1/1/89-12/31/91 is 60% S&P 500/40% LB Aggregate,  
1/1/92-12/31/94 is 50% S&P 500/40% LB Aggregate/10% EAFE,  
1/1/95-6/30/97 is 45% S&P 500/40% LB Aggregate/15% EAFE,  
7/1/97-12/31/99 is 50% S&P 500/35% LB Aggregate/15% EAFE,  
1/1/00-Present is 53% S&P 500/30% LB Aggregate/17% EAFE.

## 12. Presentation, Discussion and Appropriate Action Regarding the Performance of the MidCap Managers for the Period Ending September 30, 2003

Mr. Gary R. Dokes, Chief Investment Officer, and Mr. Terry Dennison gave a brief overview of the MidCap Managers presentations.

Mr. John Cone, President, and Mr. Paul Healey, Executive Vice President and Chief Operations Officer, presented for Franklin Portfolio Associates.

### Absolute and Relative Performance:

	<b>Q303</b>	<b>YTD</b>	<b>1 Year</b>	<b>Inception*</b>
<b>ASRS</b>	7.10	20.90	26.90	6.10
<b>S&amp;P 400</b>	6.60	19.80	26.80	4.60
<b>Relative Return</b>	0.50	1.10	0.10	1.50

\* 7/1/02

### Attribution Analysis:

	<b>Quarter</b>	<b>YTD</b>	<b>1 Year</b>	<b>Inception*</b>
<b>Sector Selection</b>	0.00	0.30	0.40	0.40
<b>Stock Selection</b>	1.10	1.70	1.20	1.40
<b>Others</b>	-0.50	-0.80	-1.30	-0.10
<b>Fees (%)</b>	-0.10	-0.10	-0.20	-0.20
<b>Total Value Added</b>	0.50	1.10	0.10	1.50

\* 7/1/02.

Mr. Phillip Perelmutter, Portfolio Manager, and Ms. Elizabeth O'Hara, Relationship Manager, presented for Wellington Management Company.

### Absolute and Relative Performance:

	<b>Q303</b>	<b>1 Year</b>	<b>Inception*</b>
<b>ASRS</b>	3.03%	28.31%	3.70%
<b>S&amp;P 400</b>	6.59	26.81	4.63
<b>Relative Return</b>	-3.56	1.50	-0.93

\* 6/30/02

### Attribution Analysis:

	<b>Quarter</b>	<b>1 Year</b>	<b>Inception*</b>
<b>Sector Selection</b>	-0.80	-0.90	0.130
<b>Stock Selection</b>	-2.61	2.96	-0.50
<b>Fees (%)</b>	-0.15	-0.56	-0.56
<b>Total Value Added</b>	-3.56	1.50	-0.93

\* 6/30/02

Mr. Thomas Pernice, Director of Client Relations and Mr. Charles W. Rupinski, Portfolio Analyst, presented for Forstmann-Leff Associates.

Absolute and Relative Performance:

	<b>Q303</b>	<b>1 Year</b>	<b>Inception*</b>
<b>ASRS</b>	6.40	23.76	-2.01
<b>S&amp;P 400</b>	5.99	25.36	5.64
<b>Relative Return</b>	0.42	-1.60	-7.65

\* 6/30/02

Attribution Analysis:

	<b>Quarter</b>	<b>1 Year</b>	<b>Inception*</b>
<b>Sector Selection</b>	-0.26	-2.94	-1.31
<b>Stock Selection</b>	0.72	1.66	-6.21
<b>Other (Trading)</b>	0.03	0.03	0.17
<b>Fees (%)</b>	-0.07	-0.35	-0.30
<b>Total Value Added</b>	0.42	-1.60	-7.65

\* 6/30/02

Mr. John G. Higgins, Senior Vice President, presented for Frontier Capital Management Company.

Absolute and Relative Performance:

	<b>Q303</b>	<b>1 Year</b>	<b>Inception*</b>
<b>ASRS</b>	5.49	31.72	3.10
<b>S&amp;P 400</b>	5.99	25.35	5.64
<b>Relative Return</b>	-0.50	6.36	-2.54

\* 6/30/02

Attribution Analysis:

	<b>Quarter</b>	<b>1 Year</b>	<b>Inception*</b>
<b>Sector Selection</b>	0.55	1.42	-1.09
<b>Stock Selection</b>	-0.16	8.20	0.10
<b>Other</b>	-0.71	-2.55	-0.83
<b>Fees (%)</b>	-0.18	-0.71	-0.72
<b>Total Value Added</b>	-0.50	6.36	-2.54

\* 6/30/02

Mr. Tom O'Brien and Mr. Neil Tremblay presented for State Street Global Associates.

Absolute and Relative Performance:

	<b>Q303</b>	<b>1 Year</b>	<b>3 Year</b>	<b>Inception*</b>
<b>ASRS</b>	6.55	26.67	-0.68	6.00

<b>S&amp;P 400</b>	6.59	26.82	-0.71	5.83
<b>Relative Return</b>	-0.04	-0.15	0.03	0.17

\* 1/31/01

Attribution Analysis:

	<b>Quarter</b>	<b>1 Year</b>	<b>3 Year</b>	<b>Inception*</b>
<b>Futures</b>	0.00	-0.01	0.01	0.01
<b>Cumulative misweights</b>	-0.03	-0.78	-0.00	-0.00
<b>Trading of index changes</b>	0.00	0.00	0.02	0.03
<b>Fees</b>	-0.01	-0.03	-0.03	-0.03
<b>Corporate actions</b>	0.00	0.00	0.04	0.03
<b>Initial contribution trade</b>	0.00	0.00	0.00	0.14
<b>Compounding</b>	-0.00	-0.02	-0.01	-0.02
<b>Value added</b>	-0.04	-0.14	0.03	0.17

\* 1/31/01

Mr. Michael C. Viteri, ASRS Equity Portfolio Manager, and Mr. Eric Rovelli, ASRS Assistant Portfolio Manager, presented the ASRS E3 & E4 Equity Portfolios.

Absolute and Relative Performance for E3:

	<b>Q303</b>	<b>YTD</b>	<b>1 Year</b>	<b>Inception*</b>
<b>E3 Model</b>	5.95	19.25	25.18	-1.84
<b>S&amp;P MidCap</b>	5.99	19.25	25.36	-2.45
<b>Relative Return</b>	-0.06	0.00	-0.18	0.61

\* 11/30/00

Attribution Analysis for E3:

	<b>Quarter</b>	<b>YTD</b>	<b>1 Year</b>	<b>Inception*</b>
<b>Sector Weightings</b>	0.00	0.00	0.00	0.00
<b>Security Weights</b>	0.00	0.00	0.00	0.00
<b>Futures &amp; ETF's</b>	0.03	0.02	0.06	0.25
<b>Trading of Index Changes</b>	-0.09	-0.02	-0.24	0.36
<b>Investment Management Fees</b>	0.00	0.00	0.00	0.00
<b>All Other Factors</b>	0.00	0.00	0.00	0.00
<b>Total Value Added</b>	-0.06	0.00	-0.18	0.61

\* 11/30/00

Absolute and Relative Performance for E4:

	<b>Q303</b>	<b>YTD</b>	<b>1 Year</b>	<b>Inception*</b>
<b>E4 Model</b>	7.20	20.45	28.30	3.70
<b>S&amp;P MidCap</b>	7.19	20.33	28.23	3.62
<b>Relative Return</b>	0.01	0.12	0.07	0.08

\* 6/30/02

Attribution Analysis for E4:

	<b>Quarter</b>	<b>YTD</b>	<b>1 Year</b>	<b>Inception*</b>
<b>Sector Weightings</b>	0.00	0.00	0.00	0.00
<b>Security Weights</b>	0.00	0.00	0.00	0.00
<b>Futures &amp; ETF's</b>	-0.02	-0.02	-0.05	0.03
<b>Trading of Index Changes</b>	0.03	0.14	0.12	0.05
<b>Investment Management Fees</b>	0.00	0.00	0.00	0.00
<b>All Other Factors</b>	0.00	0.00	0.00	0.00
<b>Total Value Added</b>	0.01	0.12	0.07	0.08

\* 6/30/02

**13. Presentation, Discussion and Appropriate Action Regarding the ASRS Board Committee Structure and Charters**

Mr. Paul Matson, ASRS Director, presented a restructuring of the Committees to the ASRS Board. All items that would be handled by a Committee would fall under review by the following three Committees: Operations Review Committee, External Affairs Review Committee, and Investment Review Committee. Special (Ad Hoc) Committees would be established as needed.

Dr. Chuck Essigs stated that the Budget may fall under both the External Affairs and Operations Committees. Mr. Anthony Guarino, ASRS Chief Operations Officer, said that was indeed the case but for committee purposes should be under the Operations Committee. Mr. Jim Bruner said that he supported the 3-Committee structure. Mr. Norman Miller asked questions about specific issues and where they would be handled. He also asked how many Board trustees would be on each Committee. Mr. Matson suggested that there be a minimum of three trustees on each Committee, with a maximum of four members.

**Motion:** Ms. Charlotte Borchert moved the Board accept the Alternate Board Committee Structure as presented by staff effective January 1, 2004.

Mr. Steven Zeman seconded the motion.

Dr. Keith Meredith raised the issue of how many trustees should be on each Committee. He suggested four members per Committee. Mr. Matson said that the alternative plan only sets a minimum of three members per Committee, not a maximum of three. Mr. Jim Bruner reminded the Board that the Investment Review Committee currently has five members and there is no problem with any quorum issue if the meeting is a public meeting.

**Motion to Amend:** Dr. Keith Meredith moved that Ms. Charlotte Borchert's motion be amended to include that each Committee will have a minimum of four trustees.

Mr. Norman Miller seconded the motion to amend.

By a vote of 7 in favor, 1 opposed, 0 abstentions and 0 excused, the motion to amend was approved.

Ms. Charlotte Borchert opposed the Motion to Amend.

Mr. Karl Polen called for a vote on the Motion as Amended.

By a vote of 7 in favor, 1 opposed, 0 abstentions and 0 excused, the motion was approved.

Ms. Charlotte Borchert opposed the Motion.

**14. Presentation, Discussion and Appropriate Action Regarding the Adoption of the Fiscal Year for Board Officers Terms and Election of Officers or Term Extensions for the Existing Officers**

Mr. Karl Polen presented a proposal to make the Board Elections for Officers run on a Fiscal Year cycle instead of the current calendar year cycle. Mr. Jim Bruner said that as long as he has been on the Board, the Board has gone back and forth between the two cycles.

**Motion:** Mr. Jim Bruner moved the Board adopt the fiscal year for Board Officers' terms and election of Officers.

Dr. Chuck Essigs seconded the motion.

By a vote of 7 in favor, 1 opposed, 0 abstentions and 0 excused, the motion was approved.

Ms. Charlotte Borchert opposed the Motion.

**Motion:** Mr. Jim Bruner moved the Board extend the term of the current Chairman and Vice Chairman through June 30, 2004.

Mr. Steven Zeman seconded the motion.

By a vote of 8 in favor, 0 opposed, 0 abstentions and 0 excused, the motion was approved.

**15. Director's Report**

Mr. Paul Matson stated that the Board Governance handbook will be ready for the Board Trustees by the end of the year.

**16. Brief Summary of Current Events**

None.

**17. Request for Agenda Items**

None.

**18. Call to the Public**

Mr. William Peltier addressed the Board regarding the recent mutual fund scandals and asked if the ASRS was affected by the scandal. Mr. Terry Dennison gave a brief overview of the scandal and said that none of the ASRS managers were involved in the scandal, but that they are keeping an eye on the continuing investigation into the problem.

Mr. Norman Miller asked Mr. Dennison to address the Board regarding Mercer's relationship with Putnam. Mr. Dennison said Mercer has a common parent company with Putnam. However, Putnam is treated as a separate manager and does not receive any special consideration.

**19. The next ASRS Board meeting is scheduled for Friday, January 16, 2004, at 8:30 a.m., at 3300 N. Central Avenue, 10<sup>th</sup> Floor Board Room, Phoenix, Arizona.**

**20. Adjournment of the ASRS Board.**

Mr. Karl Polen, Chairman, adjourned the December 19, 2003, meeting of the ASRS Board at 11:29 a.m.

ARIZONA STATE RETIREMENT SYSTEM

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Zachary Kucera, Secretary

Date

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Paul Matson, Director

Date